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7/12/83

Financial Markets

Irving Trust

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Economic Research &
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Friday
(Noon)

June 3, 1983

The prices of financial market instruments took another drubbing following release of the money supply number last Friday. While money supply was up--again--the real culprit this time seems to have been the minutes released for the March 28-29 FOMC meeting. Deliberations at that meeting seemed to focus policy more closely on M1 because the meeting produced a short-term target for M1, benchmarked from a base in March to an end in June. The market's adverse reaction to this revelation does not simply owe to the fact that a target was set, but also to the fact that M1 is now way over the top of that target. The worry is that the Fed might tighten, and soon.

The response of the markets was very rational. However, certain (unnamed) FOMC members subsequently were cited in the press as saying the Fed had not agreed to tighten, at least not yet. There does appear to be a split within the FOMC, and it is not clear what policy is in force. At present, the Fed can run almost any policy it wants based on its own assessments and prescriptions for action. The Fed could toss out M1 as a target on grounds of (continued) bizarre velocity performance. But, if this were done, could the other targets still be taken as "serious" or would the markets come to feel that the Fed would discard any intermediate target that stood in the way of the Fed's true intermediate target? (Presumably, that would be interest rates, without being precise about which ones.)

Although feasible, I think it would be difficult for the Fed to step away from its M1 target. Indeed the setting of a short-run target underscores the Fed's attempt to rejuvenate M1 in some form. In March, that short-run growth target of 6%-7% would have seemed quite attainable. M1 for the month had been boosted to a huge $497.6 billion, although this precise figure was not yet known at the time of the meeting. Thus, with strong growth-damping seasonals coming in April, the June target must have seemed reachable. Besides, the target itself was not stringent; if it were extrapolated to the end of the year, it would not even bring M1 inside the annual growth range set in February. Yet it now seems implausible that the Fed can reach the short-run target in June.

The Fed missed its M1 target in 1982. For 1983, it set a high base and very generous upper growth bound. To now have set and missed a short-run target that allows even greater growth through mid-year looks very bad. All of this indicates how much less monetarist the Fed has become. The market's concern is also over the protracted period of rapid M1 growth. Over the last year, M1 has speeded ahead at nearly a 12% annual rate; faster over more recent periods. The Fed may cease to have credibility if it sets yet another target for M1. Moreover, retreat to the broader aggregates now seems to promise less leeway for action than it did earlier. Yet the Fed's policies have been couched in terms of the monetary aggregates and the use of nonborrowed reserves for so long, it's doubtful that the Fed can change this course. Therefore, a compelling case can be made for the Fed's being forced to tighten. In addition, the strength of the economy is an important factor. It does seem to provide the scope for the Fed to move. While money growth can be fickle, at least a modest tightening before too long seems inevitable.

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Market Yields

	6/3/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	10.50%	10.50%	16.50%
Effective since	2/28/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.63	8.50	13.50
Repurchase Agreements	8.63	8.13	13.50
U.S. Treasury Issues			
Bills			
3 months	8.84	8.74	12.64
6 months	9.20	9.01	13.05
1 year	9.39	9.23	13.45
Coupons			
2 years	10.02	9.86	13.95
4 years	10.38	10.18	13.95
7 years	10.74	10.54	14.00
10 years	10.78	10.58	13.90
Long Bond	10.92	10.74	13.70
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.80	8.65	13.65
3 months	8.95	8.80	13.85
6 months	9.20	9.10	13.90
1 year	9.55	9.40	14.00
Banker's Acceptances			
1 month	8.87	8.66	13.55
3 months	9.00	8.85	13.75
6 months	9.16	9.10	13.90
Eurodollar Deposits			
1 month	9.13	9.06	14.25
2 months	9.25	9.13	14.63
3 months	9.38	9.25	14.69
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.76	8.63	13.60
1 month	8.94	8.68	13.72
3 months	9.07	8.81	13.89
Bank Holding Companies			
1 month	8.81	8.30	13.58
Dealer Placed:			
3 months	9.04	8.89	13.89
New AA Corporate Utility Bond	11.70	11.65	16.30
Tax Exempt			
6 month Project Notes	4.95	4.75	7.60
1 year AAA Bond	5.50	5.50	7.75
5 year AAA Bond	7.00	7.00	9.00
20 year AAA Bond	9.50	9.10	11.40

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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